California

Economic Update

Summer 2002 | California Technology, Trade and Commerce Agency | ERSI Division

California Economy Weathers the Downturn

The California economy has experienced both expected and unforeseen challenges to its growth and competitiveness during the past two years. Among other impacts, the state has been affected by the "dot.com" bust, an electricity crisis, the national effects of the September 11, 2001 terrorist attack, and weak economic growth globally.

This article summarizes state economic trends over the past year, and discusses the path towards recovery.

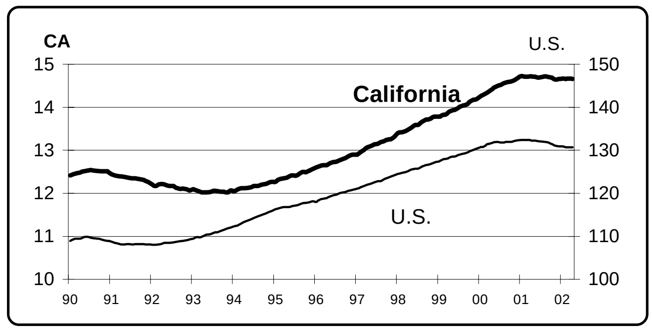
Pre-September 11th Conditions. California economic growth was outperforming the nation just prior to the September 11 terrorist attacks, but like the U.S., the pace of growth was slowing.

Prior to September 11, only a few of the U.S. economic indicators were giving recovery signals, and some of those were starting to weaken. U.S. labor force employment, seasonally adjusted, peaked at 135.89 million in December 2000, and had fallen by 0.9 million workers in the subsequent eight months.

In addition, the major international economies were slowing significantly. Economic growth in Europe was barely above 0.5 percent. In Japan, the economic contraction that started in mid-2000 was accelerating. There was essentially no economic growth in Mexico and Canada, the number one and number three trading partners of California.

The California economy clearly outperformed the U.S economy starting in 2000, as the accompanying employment graph shows. However, even with that momentum, the California economy was slowing by September, primarily due to the weakness of the national and international economies. The California unemployment rate was just nudging 5.5 percent in August 2001, after reaching a low of 4.7 percent in February 2001. California labor force employment, seasonally adjusted, peaked in April 2001 at 16.45 million people, and had fallen by only 17,000 people in the subsequent four months. (Note that California reached its peak some four months after the peak of U.S. labor force employment.)

Millions of Nonfarm Jobs
1990 to 2002Q1



September 11th To Early 2002 Trends. The terrorist attacks on September 11th not only created direct disruptions in the national and state economies, but also created a sense of uncertainty that indirectly reduced consumer and business activity. California's economy generally fared better than the rest of the nation. By March 2002, the state's unemployment rate had risen less, and fewer jobs were lost, compared to the U.S. Labor force employment was down only 0.5 percent from one year ago for California, compared to a 1.5 percent decline for the nation.

(Continued on the back page.)

Highlights

Like the US economy, growth of the California economy has slowed, but there are signs of improvement. And California may have recovered sooner. Seasonally-adjusted job growth resumed in December for the state but was still declining through the first quarter for the nation.

Labor force employment averaged 16.5 million people in the first quarter, an increase of 0.2 percent. Employment grew in all regions of the state except the Bay Area. The statewide unemployment rate was 6.4 percent compared to 6.0 percent one year ago. ***See State Labor Market Conditions, Page 2.***

Residential construction continued to do well. Existing homes led the way, as sales were up sharply, prices increased, unsold inventory declined, and the time it took to sell a home decreased. Relatively low interest rates in the first quarter were a stimulus to housing construction and sales. ***See Real Estate Trends, Page 4.***

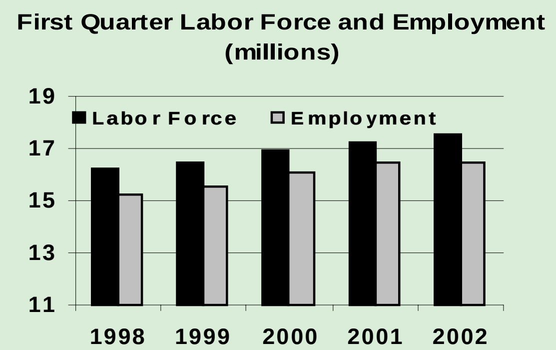
Wage and salary jobs fell slightly in the first quarter. Declines in the sectors of manufacturing, transportation, and services were offset by gains in construction, retail trade, finance, and government. The regions of Central Valley, Inland Empire, and San Diego were the fastest growing. ***See Industry Trends, Page 5.***

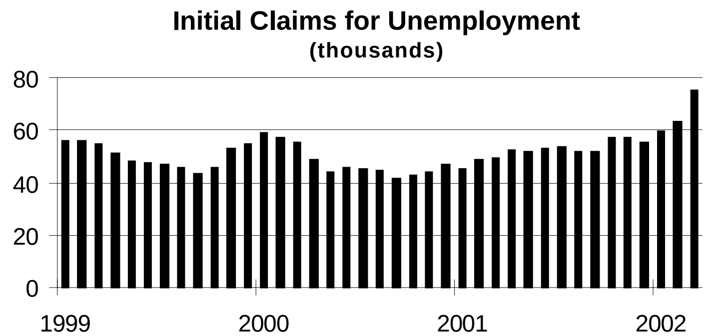
Personal income totaled 1.1 trillion in the fourth quarter, the latest data available. Wage and salary income shrank 2.1 percent from one year ago. Short-term interest rates declined significantly in 2001, and longer-term rates declined somewhat less. Inflation remained low. ***See Other Economic Trends, Page 6.***

State Labor Market Conditions

California's seasonally adjusted labor force employment averaged 16.5 million in the first quarter, an increase of 0.2 percent from the prior quarter, and only a 0.1 percent increase from a year ago. However, labor force employment peaked in February and then declined in March. In February, the number of participants in the total labor force exceeded 17.6 million for the first time.

Unemployment levels averaged 1,108,000 in the first quarter, an increase of 52,000, or 4.9 percent, compared to the fourth quarter of 2001. Compared to one year ago, first quarter unemployment increased 35.5 percent, an additional 290,000 persons. The California unemployment rate averaged 6.3 percent in the first quarter compared to the U.S. rate of 5.6 percent. The total number of unemployed exceeded the 1.1 million mark in January 2002.





Manufacturing employment in March decreased by 123,800, a 6.3 percent decline from one year ago, with 81 percent of the decrease occurring in durable goods manufacturing. Electronic equipment employment decreased by 39,600, a 13.8 percent decline from the previous year. Weekly earnings increased 2.4 percent and hours declined by 0.4 percent. Manufacturing overtime decreased by 6.3 percent, lessening the potential for new hires.

Regional Conditions

Nonseasonally adjusted employment increased in all regions of the state except the Bay Area in the first quarter of 2002, compared with the first quarter of 2001. Unemployment increased in all regions of the state.

The Central Valley/Sierra and Central Coast regions both had a double-digit unemployment rate in the first quarter. The Northern California region was not far behind with a 9.8 percent rate. The remaining regions had an unemployment rate ranging between 3.8 and 6.5 percent. The lowest unemployment rates were 3.8 percent in Orange County and 4.3 percent in San Diego County. The unemployment rate in the San Francisco Bay region increased 3.5 percent year-over-year to 6.0 percent in the first quarter.

Total non-farm employment in the San Francisco Bay region decreased by 120,600 in the first quarter, a decline of 3.3 percent. Santa Clara County took the biggest hit with a loss of 79,000, a decrease of 7.9 percent from a year ago. The Santa Clara County unemployment rate jumped from 1.9 percent to 7.6 percent. The rate for the City and County of San Francisco was seven percent.

Employment in Southern California remained stable, increasing by only 0.2 percent in the Los Angeles region. Orange County employment increased 1 percent, while San Diego's increased 2.2 percent. The Inland Empire again led Southern California with a 3.4 percent increase, an additional 50,700 persons.

In predominately rural Northern California, employment decreased in six of the 18 counties. In eight of the counties the unemployment rate was within 0.5 percentage points of the year-ago rate. In Nevada County the unemployment rate increased 1.1 percentage points to 5 percent. In Trinity County the rate decreased 2.8 percentage points to 13.7 percent.

In the Central Valley/Sierra region, employment increased by over 16,000, with both San Joaquin and Stanislaus Counties experiencing employment increases of almost 6,000 persons each over the first quarter of 2001. Employment in the Sacramento region increased 1.5 percent compared with a year ago.

California Economic Update

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Regional Employment Profile

Employment by Region

Region	Employment Change 2001:1 to 2002:1 Persons	Percent	Unemployment Rate (%) 2002:1	2001:1
Northern CA	**5,080**	**1.1**	**9.8**	**9.4**
Bay Area	**-120,600**	**-3.3**	**6.0**	**2.5**
Sacramento	**13,657**	**1.5**	**5.2**	**4.2**
Central Valley/Sierra	**16,207**	**1.2**	**14.3**	**14.1**
Central Coast	**2,673**	**0.6**	**10.6**	**9.7**
Los Angeles	**8,367**	**0.2**	**6.5**	**5.0**
Orange	**14,233**	**1.0**	**3.8**	**2.4**
San Diego	**30,600**	**2.2**	**4.3**	**3.4**
Inland Empire	**50,700**	**3.4**	**5.4**	**4.7**
CALIFORNIA	**20,917**	**0.1**	**6.7**	**5.1**

Employment and unemployment estimates are not seasonally adjusted. Data are based on the 2001 Benchmark, and are derived from U.S. Department of Labor-developed regression models put into place January 1996.

County	Persons Employed 2002:1	2001:1	Unemployment Rate 2002:1	2001:1
Northern California				
Butte	81,300	80,800	8.5%	8.2%
Colusa	6,200	6,223	26.2%	27.1%
Del Norte	8,820	8,743	10.1%	10.1%
Glenn	9,010	8,707	13.4%	14.7%
Humboldt	54,767	54,900	7.4%	7.2%
Lake	21,840	20,840	9.4%	8.6%
Lassen	10,127	9,970	9.4%	9.9%
Mendocino	39,433	38,257	8.9%	8.3%
Modoc	3,647	3,473	10.3%	10.8%
Nevada	43,657	43,683	5.0%	3.9%
Plumas	8,313	8,157	13.9%	13.8%
Shasta	71,267	69,500	8.9%	8.1%
Sierra	1,210	1,167	15.3%	16.2%
Siskiyou	14,583	15,163	13.3%	12.4%
Sutter	30,800	31,000	15.8%	15.6%
Tehama	23,557	23,133	7.8%	8.0%
Trinity	4,527	4,093	13.7%	16.5%
Yuba	17,967	18,133	15.3%	14.2%
Bay Area				
Alameda	719,633	724,200	6.4%	2.9%
Contra Costa	492,167	495,333	4.7%	2.7%
Marin	131,233	136,400	3.7%	1.8%
Napa	63,900	62,800	4.4%	3.2%
San Francisco	403,833	419,900	7.0%	3.5%
San Mateo	386,367	401,733	4.5%	1.7%
Santa Clara	925,267	1,004,267	7.6%	1.9%
Solano	191,467	188,200	5.4%	4.1%
Sonoma	251,400	253,033	4.5%	2.6%
Sacramento				
Alpine	750	697	5.9%	6.7%
Amador	14,250	14,063	4.9%	4.6%
Calaveras	15,013	14,030	7.2%	7.3%
El Dorado	81,233	80,033	4.9%	4.0%
Placer	123,733	122,033	4.8%	3.4%
Sacramento	594,333	585,800	5.2%	4.1%
Yolo	87,800	86,800	6.0%	5.5%
Central Valley/Sierra				
Fresno	318,333	317,033	16.2%	16.7%
Inyo	7,010	6,727	6.2%	6.0%
Kern	251,633	248,633	13.0%	12.7%
Kings	37,107	37,967	17.3%	17.2%
Madera	45,500	45,300	15.0%	14.6%
Mariposa	6,317	5,747	9.0%	9.8%
Merced	68,333	68,400	18.1%	18.0%
Mono	6,733	6,910	5.0%	4.5%
San Joaquin	238,633	232,733	11.1%	10.0%
Stanislaus	185,533	179,567	12.4%	11.8%
Tulare	137,400	138,333	18.3%	18.2%
Tuolumne	20,293	19,270	7.3%	7.2%
Central Coast				
Monterey	162,900	163,467	15.5%	14.7%
San Benito	24,303	24,063	11.6%	9.8%
San Luis Obispo	115,733	112,667	3.3%	3.2%
Santa Cruz	129,367	129,433	9.9%	8.1%
Los Angeles				
Los Angeles	4,587,067	4,584,100	6.7%	5.1%
Santa Barbara	191,800	191,600	4.6%	4.3%
Ventura	401,200	396,000	5.0%	4.1%
Orange County				
Orange	1,502,433	1,488,200	3.8%	2.4%
San Diego				
Imperial	46,267	43,733	14.8%	19.0%
San Diego	1,400,833	1,372,767	3.9%	2.8%
Inland Empire				
Riverside	728,400	704,133	5.5%	4.8%
San Bernardino	794,233	767,800	5.3%	4.6%
California	16,340,767	16,319,850	6.7%	5.1%

Real Estate Trends

Residential

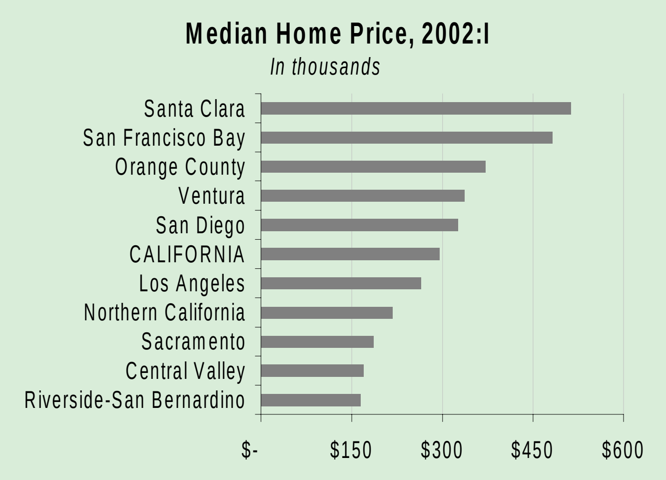
New residential construction continued to do well during the first quarter of 2002. The 35,000 new housing units was only a few percentage points lower than the prior quarter level, and from the same quarter last year. Given the weak economic condition, and the steady declines in nonresidential activity, housing has been a source of strength to the California economy.

Single-family homes continued to be in the greatest demand, representing about three fourths of all new housing units built in the first quarter. Such homes represented about $4.0 billion of the $5.3 billion in new residential construction value. New multiple-family units, and additions and alterations to existing units, accounted for the remaining valuation.

Existing home sales also reflected the demand for housing during the first quarter. Compared to a year earlier, sales were up sharply, prices increased, unsold inventory declined, and the time it took to sell a home decreased.

The median single-family home price in the state was $295,000 during the quarter, up nearly a fifth from a year earlier. The coastal areas of the state continued to have the highest home prices. The northern, central, and inland areas of the state had median prices that were about a third lower than the statewide price.

Relatively low interest rates in the first quarter were a stimulus to housing construction and sales. Adjustable home mortgage rates averaged about five percent, compared to 6.5 percent a year earlier. Thirty-year fixed rates were about seven percent during the first quarters of both 2001 and 2002.



Nonresidential

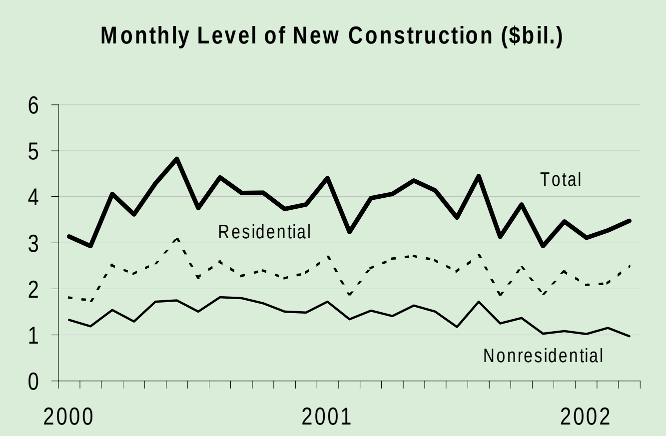
The value of nonresidential construction authorized by building permits peaked in the fall of 2000 at about $1.8 billion per month. Since that time, activity gradually declined to the point that valuation for March 2002 was about half the peak rate.

Despite the overall decline, the various construction categories differed in their trends. New store construction held up fairly well as consumers continued to spend. Additions and alterations also did better than the average, due to the lower cost in fixing up existing structures versus building new ones.

Industrial construction has had a difficult time due to a decline in manufacturing, and particularly of technology goods. Industrial vacancy rates in Silicon Valley (Santa Clara County and surrounding areas) were up sharply during the past year. In the first quarter of 2002, the overall rate was nearly 11 percent, compared to about four percent a year earlier. Lease rates have also been falling, reflecting the excess amount of sublease space.

Local demand for office space varied widely throughout the state. Areas such as San Francisco, which lost many dot.com companies, saw vacancies approach 20 percent. In contrast, more diversified office markets, such as Sacramento, kept their rates below ten percent in the first quarter of 2002.

Future nonresidential construction activity will likely be restrained given the current excess capacity, and the relatively slow rebound expected for economy this year.



Industry Trends

California employment increased by 0.1 percent in the first quarter of 2002 compared to a year ago, with employment growth occurring primarily in Southern California. Employment peaked in February 2002 at 16.5 million and then declined to 16.4 million in March. Nationally, jobs declined 1.4 percent from the first quarter of 2001.

Total nonfarm employment declined 0.3 percent compared with the first quarter of 2001. Government was the fastest growing sector, posting a 3.6 percent increase in employment from the year-ago quarter. Local education, a major part of the government sector, increased 3.8 percent.

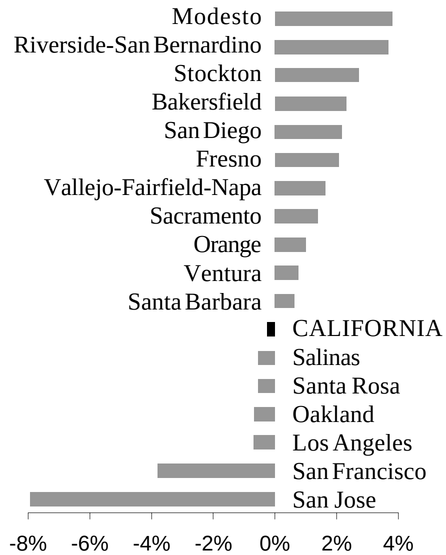
The financial sector grew 1.5 percent from the first quarter of 2001, while construction employment increased 0.9 percent. Transportation, communication and utilities declined 3.7 percent from a year ago.

The services sector declined 0.4 percent from a year ago, although industry trends were mixed. Motion picture production declined 11 percent, while the demand for business services decreased 5.8 percent. On the plus side, amusement and recreation services and health services employment both increased 3.3 percent. Employment in business professions increased 2.4 percent.

Manufacturing employment decreased 6.3 percent, with all major industry groups experiencing declines. Industrial machinery declined 13.2 percent, electrical equipment declined 5 percent, and transportation equipment and instruments both declined 3.3 percent.

Other sectors posted modest changes, from a 1 percent increase in retail trade to a 0.9 percent decrease in wholesale trade.

One-Year Job Change by CA MSA
First Quarter 2002



The Central Valley (Modesto, Stockton, Bakersfield, Fresno), Riverside-San Bernardino, and San Diego Metropolitan Statistical Areas (MSAs) were the fastest growing regions in the state during the first quarter. In contrast, jobs declined 7.9 percent in the San Jose MSA and 3.8 percent in the San Francisco MSA. Job losses in the San Jose MSA were driven by a 17.7 percent decline in business services and a 14.4 percent decline in durable goods manufacturing.

California Industries Lead in Exports

California is the leading state in the value of goods exported. In 2001, the state exported nearly $107 billion in goods, or nearly 15 percent of total U.S. exports.

California's main export strength is its diversity. The state is home to several important export industries, including computers and information technology, entertainment, agriculture, chemical production, and aerospace. Export sales exceeded $1 billion in 16 of the 31 categories under the NAICS (North American Industry Classification System) series. Within these categories, California leads the nation in exports of computer and electronic products, and food and kindred products.

Computer and electronic product exports from the state totaled $50.3 billion in 2001. The next four largest export categories were non-electrical equipment ($10.7 billion), transportation equipment ($8.4 billion), chemicals ($5.2 billion), and miscellaneous manufactured products ($4.4 billion).

International trade results in industry jobs for more than 1.5 million Californians. This amount represents more than ten percent of total private sector employment in the state. The number of export-related jobs is also the highest among the 50 states. In addition, California workers in jobs supported by trade earn wages that are 13 to 18 percent higher than the national average wage.

The key to California's export success is not only product diversity, but also the diversity of the state's export markets. Those markets, and the volume of exports in each market, reflect the state's location on the edge of the Pacific Rim and its shared border with Mexico. In 2001, California exported goods to 219 countries. The state's leading export markets include Mexico ($16.3 billion in California exports), Japan ($14.6 billion), Canada ($11.8 billion), and Taiwan and the United Kingdom ($5.6 billion each).

Total California exports declined by 10.7 percent from the record-high level reached in the year 2000 ($119.6 billion). The decrease in exports was attributable to the global economic slowdown, which intensified after the attacks of September 11th.

The International Trade and Investment Division, of the Technology, Trade and Commerce Agency, is a catalyst for creating jobs in California through ongoing promotion of California exports and foreign investment in the state.

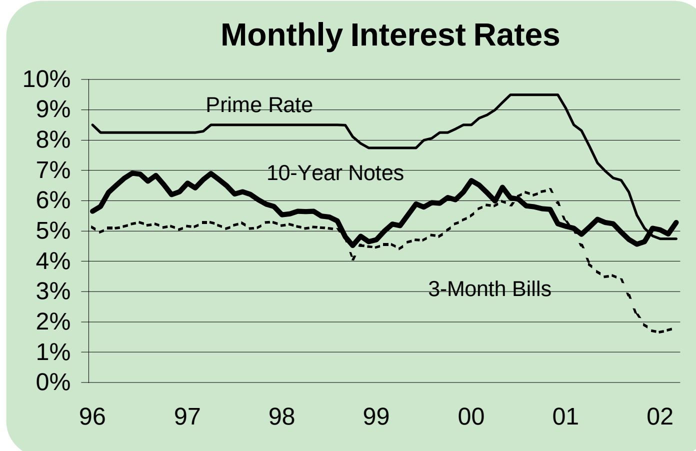
Top U.S. Exporting States

Rank	State	2001 Value ($ billion)	% Of U.S. Total
1	California	106.8	14.6
2	Texas	95.0	13.0
3	New York	42.2	5.7
4	Washington	34.9	4.7
5	Michigan	32.3	4.4

Source: Massachusetts Institute of Social and Economic Research (MISER)

Other Economic Trends

Interest Rates

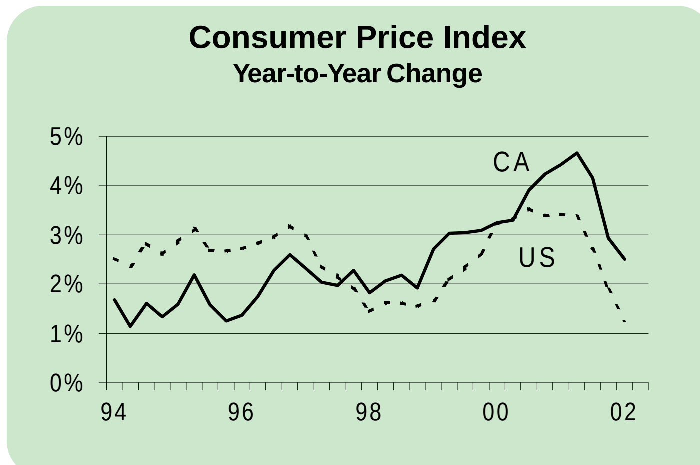


Short-term interest rates tended to stabilize during the first quarter of 2002, following steady declines throughout 2001. Three-month Treasury bill yields averaged 1.7 percent in the quarter, compared to more than four percent during the same month last year.

The Federal Reserve lowered the federal funds rate 12 times during 2001, from 6.0 percent to 1.75 percent. (That is the rate that depository institutions lend balances at the Fed to other such institutions overnight.) In its January and March meetings, the Fed left the rate unchanged at 1.75 percent.

Longer-term rates were much less prone to declines. Ten-year Treasury notes averaged about five percent during the first quarter, which was about the average rate for the past year. The low level last year was reached in September, when the monthly rate averaged 4.7 percent. The prime rate charged by banks remained at 4.75 percent during the first quarter of 2002, the same level as at the end of 2001. New home mortgage rates declined slightly during 2001, reaching about 6.75 percent in the first quarter.

Inflation

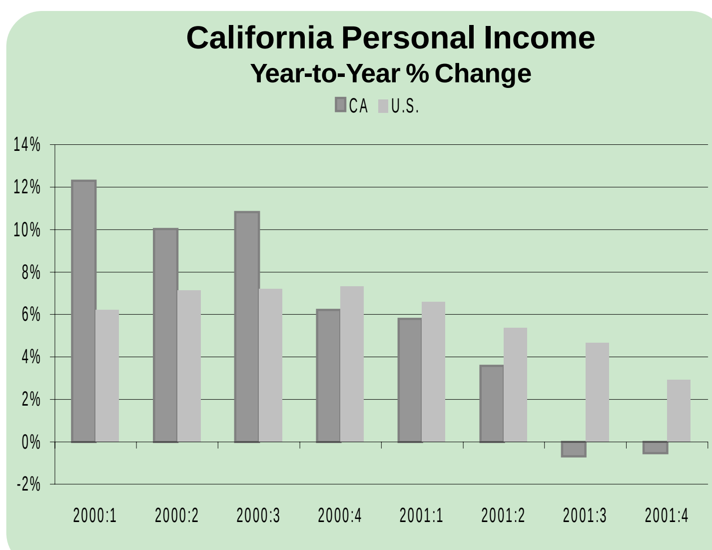


Price inflation in the state and nation, as measured by the Consumer Price Index (CPI), continued to be modest in the first quarter of 2002. The Los Angeles CPI rose 2.7 percent from the same quarter last year. The San Francisco CPI was up 1.8 percent in February, the latest month available, from the February 2001 level. The U.S. City Average CPI gained only 1.3 percent from the first quarter of 2001.

Price gains have declined sharply since the economic downturn that began in early 2001. Declining energy prices nationwide has been a factor. The energy component of the U.S. CPI declined by more than 10 percent between March 2001 and March 2002. The slightly faster pace of price gains in California is partly due to gasoline and home prices in the state.

The relatively low pace of price gains has shifted attention away from inflation concerns, and towards economic recovery. Producer prices for finished goods declined between the first quarters of 2001 and 2002. The decrease provided further indication of the weak economy, and the likelihood for low inflation in the near future.

Personal Income



California personal income totaled $1.1 trillion in the fourth quarter of 2001, the latest data available. The level was down slightly compared to the prior quarter, and to the fourth quarter of 2000. Total personal income reached an all-time high of $1.139 trillion in the first quarter of 2001, and has been slowly declining since that time. Income in the state has been hurt by sharp decreases in technology production, and the stock market income that it generates. Nationally, personal income grew 2.9 percent in the fourth quarter.

Wage and salary income, which accounts for more than half of all personal income, shrank 2.1 percent from the fourth quarter of 2000. The manufacturing sector was particularly hard hit, falling by 13.4 percent, following a 20.0 percent year-over-year decline in the third quarter.

California Economic Indicators

	First Quarter 2002	Fourth Quarter 2001	Change from 1st Quarter 2001	Annual Change 1996-01
Labor Force				
Labor Force (thousands)	17,584	17,483	1.9%	2.3%
Employment (thousands)	16,467	16,427	0.1	2.7
Unemployment (thousands)	1,117	1,056	36.6	-3.7
Unemployment Rate (%)	6.4	6.0	-	-
Industry Employment				
Total Nonfarm (thousands)	14,445	14,637	-0.3%	2.9%
Mining	24	24	0.4	-3.8
Construction	737	773	0.9	8.7
Manufacturing	1,825	1,849	-6.3	0.6
Nondurables	1,141	1,159	-7.9	1.0
Durables	207	211	-9.6	0.9
Industrial Machinery	249	255	-13.2	1.7
Electrical Equipment	140	142	-5.0	-2.1
Transportation Equipment	178	178	-3.3	1.1
Instruments	684	690	-3.3	-0.2
Transp, Communication, Utilities	721	742	-3.7	3.2
Wholesale Trade	804	809	-0.9	1.7
Retail Trade	2,511	2,581	1.0	2.5
Finance, Insurance, Real Estate	846	850	1.5	2.7
Services	4,527	4,572	-0.4	3.7
Lodging	191	194	-3.8	1.8
Business Services	1,252	1,288	-5.8	6.1
Motion Picture Production	169	177	-11.0	1.7
Amusement, Recreation	214	214	3.3	3.1
Health	966	964	3.3	1.9
Business Professions	511	509	2.4	4.4
Government	2,450	2,438	3.6	2.4
Local Education	991	982	3.8	3.9
Farm Production & Services	413	478	-0.5	0.5
Real Estate				
Housing Units Authorized	33,900	33,400	-6.4%	9.3%
Nonresidential Valuation ($ millions)	3,147	3,470	-31.3	12.0
Median Existing Home Sales Price ($)	295,130	286,410	19.1	8.4
Market Prices Finance				
Personal Income ($ billions)	n.a.	1,099.5		6.6
Consumer Price Index				
United States	177.9	177.3	1.3	2.5
California	184.1	182.4	2.4	3.0
Corporate Aaa Bonds, Moody s (%)	6.6	6.9		
Three-Month Treasury Bills (%)	1.7	2.0		

na—not available

Quarterly figures are averages except where noted. Annual change indicates the average annual percent change over the five-year time span.

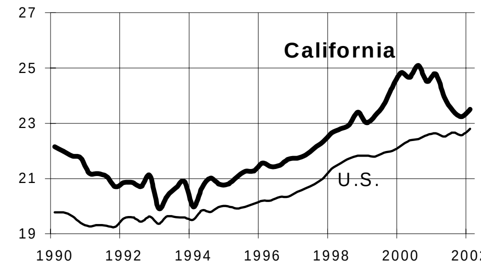
Labor Force, Unemployment. Labor force data are seasonally adjusted, and by place of residence. Estimates are provided by the Employment Development Department (EDD). Data are based on the 2001 Benchmark, and are derived from U.S. Department of Labor-developed regression models put in place January 1996.

Industry Employment. Industry employment data are not seasonally adjusted, and are by place of work. Estimates are provided by EDD. Estimates are derived from payroll records and exclude the self-employed. Multiple job holders are counted once for each job.

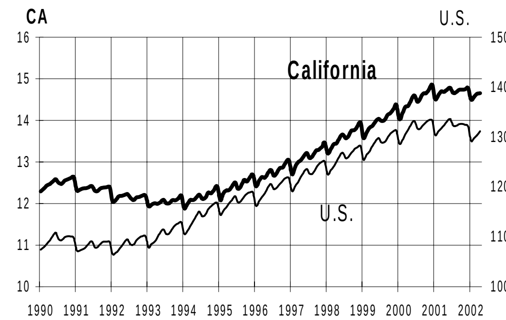
Real Estate. Housing Units Authorized and Nonresidential Valuation are quarterly totals, and not adjusted for seasonal trends or inflation.

Market, Prices, Finance. Personal income is at an annual rate, seasonally adjusted, and is revised. Other series are not seasonally adjusted.

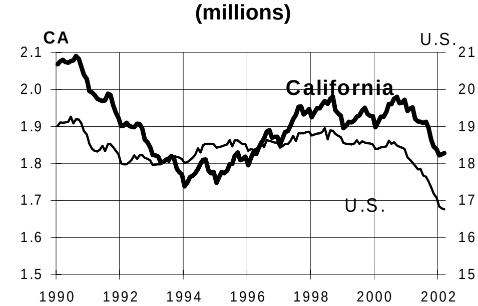
Per Capita Income
(thousand 1990 dollars)



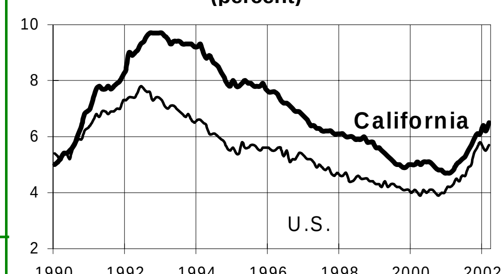
Total Nonfarm Jobs
(millions)



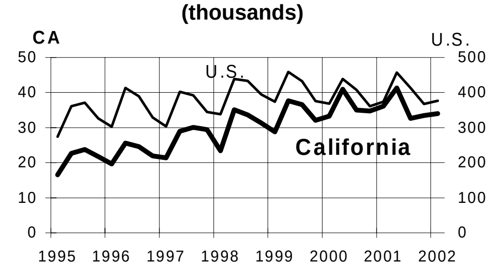
Manufacturing Jobs
(millions)



Unemployment Rate
(percent)



Housing Units Authorized
(thousands)



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The California portion of total U.S. jobs declined in two important industries – aerospace and software services — but the declines were moderate. Jobs also declined in other important industries, but at a pace commensurate with that of the nation. The September 11th terrorist attacks dealt a significant blow to travel and tourism, both for the nation and the state. Airlines, restaurants, lodging, and visitor shopping were most adversely affected. California employment in the air travel industry decreased 11.5 percent by March 2002. Lodging industry employment decreased by 2.7 percent. Big-city markets, which rely more on out-of-state and foreign visitors, fared worse than suburban and rural markets. Rural areas tend to capture in-state tourists who would have traveled elsewhere when safety or economic issues are not a concern.

The state's job losses were concentrated in the San Francisco Bay Area, an area impacted by the IT downturn as well as decline in tourism. The unemployment rate in Santa Clara County jumped from 2.2 percent in March 2001 to 7.6 percent in March 2002. Unemployment also increased in Southern California and Sacramento County, but at a lesser pace.

Trade and Investment Impacts. Weak economic conditions around the world adversely impact foreign trade and investment in California, the nation's largest exporting state. In addition, the state experienced unsustainable growth in prior years, resulting in an expected reduction in trade and investment activity. For example, California exports of goods exceeded $100 billion every year from 1996 through 2001. In the year 2000, California exports increased more than 22 percent. The state's top four export categories are high-technology industries. Mexico, Japan and Canada are the top export markets. Exports to Mexico exceeded $16 billion in 2001.

Foreign direct investment (FDI) into California is the highest among all the states. In 1999, the latest data available from the federal government, FDI book value was nearly $116 billion. California employment in domestic affiliates of foreign companies was 638,800. Official state data beyond that year is not available; however, national data indicate that new investment in the U.S. fell significantly due to the recession, weakness in other major nations, and a sharp slowdown in mergers and acquisitions.

The Path Towards Recovery. The national economy will have to work through several imbalances created during the 1990s.

One imbalance of the 1990s was the large investment by businesses, particularly in information technology equipment. As a leader in technology industries, California benefited noticeably from the boom, but also sharply felt its decline. While orders for manufactured goods are still at least 10 percent below their peak, much of the excess industry investment has been reduced and orders are slowly increasing, now reaching levels similar to those just preceding September 11, 2001.

Another imbalance is the large amount of foreign capital invested in the U.S. If better opportunities are perceived to lie elsewhere, the resulting capital flow may cause the dollar to weaken and stocks prices to fall. It appears that correction may have only started in the first quarter, and therefore has some time yet to run.

Also in the 1990s, consumer savings fell while debt increased for both consumers and businesses. Toward the end of the previous recession, consumers started a 12 to 18 month period of reducing debt. This has not yet occurred in the current slowdown. This particular imbalance becomes a problem to the extent that household budgets are impacted by declines in assets, notably housing values and the stock market, and by weak job growth. Jobs may have reached their lows in the first quarter, but job gains have been modest, as businesses wait for stronger signs of a sustained upturn.

In conclusion, every business cycle produces some sort of excesses followed by a slowdown as these are corrected. We were able to avoid some of the excesses of the past, such as large inventory buildup, thanks to the new computer inventory management techniques. However, this slowdown has its own set of challenges, including the imbalances described plus corporate accounting issues and how to pay for security against terrorism threats. These are very interesting economic times.

The Division of Economic Research and Strategic Initiatives (ERSI) prepared this article. In addition to its regular responsibilities, ERSI provides technical support to the California Economic Strategy Panel. The bipartisan Panel was established in 1993 to provide an overall long-term economic vision and strategy to guide public policy.

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